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# In the Supreme Court of the United States

OCTOBER TERM, 1971

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No. 70-236

ESTATE OF LILLIE MACMUNN STEWART, Deceased, W. ALAN HENDERSON, Executor, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 21-35) is reported at 52 T.C. 830. The opinion of the court of appeals (Pet. App. 3-20) is reported at 436 F. 2d 1281.

### JURISDICTION

The judgment of the court of appeals was entered on January 5, 1971 (Pet. App. 3-20). A petition

for rehearing was denied on March 8, 1971 (Pet. App. 1-2). The petition for a writ of certiorari was filed on June 3, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTION PRESENTED

Whether charitable remainder interests in trusts created by the decedent qualified for federal estate tax deduction under Section 2055 of the Internal Revenue Code of 1954 (prior to its amendment by the Tax Reform Act of 1969) and the applicable Treasury Regulations, notwithstanding the trustee's unrestricted discretionary powers to invade corpus for the benefit of the income beneficiaries.

## STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Section 2055(a) of the Internal Revenue Code of 1954 and Section 20.2055-2 of the Treasury Regulations on Estate Tax (1954 Code) are set forth in Appendix D to the petition (pp. 37a-40a).

## STATEMENT

On May 24, 1960, decedent created two trusts, naming as trustee the Manufacturers Hanover Trust Company of New York. Both trust instruments provided that the income be paid to the decedent for life, then to her sister for life, and then to her sister's husband for life. Upon the death of the last surviving life tenant, the corpus was to be distributed to named charitable organizations.

Each trust instrument vested in the trustee the following powers, among others, to be exercised "in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court": (1) the power to invest in and to hold any type of property, including shares of investment companies and wasting assests, without the duty to diversify investments and without regard to restrictions placed upon fiduciaries by any rule of law; (2) the power to apportion between principal and income any accrued but unpaid income on property acquired by the trust, any dividend of whatever kind, any property received upon a corporate reorganization, consolidation, merger, or dissolution, any payment in respect of a wasting asset, and "any other receipt whatsoever"; (3) the power to determine whether or not to amortize the premium at which any property might be received, and to depreciate any expense in connection with any property; (4) the power to discontinue any sinking fund or depreciation account, and to treat the same as income; and (5) the power to pay from either principal or income any deficit from the operation of any property, or any charge against the trust estate. In addition, decedent empowered her trustee "to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care." Finally, decedent provided that the trust instruments should be construed and administered ac-

cording to the laws of the State of New York. (Pet. App. 5-7.)

Decedent died on May 6, 1964. Because she retained a life interest in the two inter vivos trusts, the value of the corpus of each trust was included in her gross estate under Section 2036 of the Internal Revenue Code, and that inclusion is not in dispute. The estate, however, claimed a charitable deduction under Section 2055 for the date of death value of the two trust remainders. The Commissioner determined that the broad administrative powers vested in the trustee prevented the charitable remainder interests from being "presently ascertainable" within the meaning of Section 20.2055-2 of the Regulations, and therefore disallowed the deduction. The Tax Court overruled the Commissioner's determination, holding that although the powers contained in the trust instruments on their face were effective to permit the trustee to divert portions of corpus to the non-charitable income beneficiaries, the exercise of these powers was so restricted by the fiduciary duties imposed by New York law that no diminution of corpus would actually be allowed by the courts of that state. The court of appeals upheld the Commissioner's determination, holding that the Tax Court had erroneously interpreted New York law, which in fact offered no guarantee of protection for trust corpus against administrative erosion where, as here, the grantor vested in her trustee the broadest latitude of discretion precisely in order to insulate the trustee against litigation by the trust beneficiaries. (Pet. App. 7-8, 16-19, 21-35.)

## ARGUMENT

The decision below is correct, and in accord with decisions of this Court and other courts of appeals. There is no conflict, and the decision turns largely upon a proper construction of state (here New York) law governing the administrative powers of a fiduciary. Moreover, the issue presented has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969.

1. The principles governing estate tax deductibility of charitable bequests of remainder interests have been enunciated and reiterated in a series of decisions by this Court upholding the long-standing Treasury Regulations on the subject. Under the Regulations and decisions the bequest does not qualify for deduction unless (1) the charitable interest is "presently ascertainable, and hence severable from the noncharitable interest" (Regulations Section 20.2055-2(a)), *i.e.*, measurable by an objective standard "fixed in fact and capable of being stated in definite terms of money" (*Ithaca Trust Co.* v. *United States*, 279 U.S. 151, 154; *Merchants Bank* v. *Commissioner*, 320 U.S. 256; *Henslee* v. *Union Planters Bank*, 335 U.S. 595); and (2) viewing the circumstances as of the date of death of the decedent, "the possibility that the charitable transfer will not become effective is so remote as to be negligible" (Regulations Section 20.2055-2(b)), *i.e.*, there must be "assurance that charity will receive the bequest or some determinable part of it" (*Commissioner* v.

*Sternberger's Estate*, 348 U.S. 187, 199; *Humes* v. *United States*, 276 U.S. 487).

Applying the rationale of the above decisions, the court below correctly held that the comprehensive discretionary powers conferred by the decedent upon her trustee to allocate trust principal to income, construed in accordance with the New York law relating to the duties imposed upon a fiduciary, prevented the value of the charitable remainders in question from being "presently ascertainable" as of the date of the decedent's death, and hence from qualifying for deduction under Code Section 2055 (prior to its amendment by the Tax Reform Act of 1969) and the then applicable Treasury Regulations. The decision below is in accord not only with this Court's decisions in cases involving the deductibility of charitable remainders subject to direct invasionary power, but with other decisions in cases involving substantially the same issue here presented—deductibility of a charitable remainder subject to indirect invasion by exercise of the trustee's power of allocation between principal and income. *Florida National Bank at Lakeland* v. *United States*, 443 F. 2d 467 (C.A. 5); *Miami Beach First National Bank* v. *United States*, 443 F. 2d 475 (C.A. 5); *First National Bank in Palm Beach* v. *United States*, 443 F. 2d 480 (C.A. 5); and *Rand* v. *United States*, 28 A.F.T.R. 2d, ¶ 147,602 (C.A. 2).[1] See also *Greer* v. *United States*, 25

[1] The Third Circuit, which decided the instant case, also decided *Peoples Trust Co. of Bergen County* v. *United States*, 27 A.F.T.R. 2d, ¶ 147,582, in favor of the taxpayer. That case involves New Jersey rather than New York law,

A.F.T.R. 2d 70-1629 (D. N.C.), appeals pending C.A. 4, Nos. 15,425, 15,426; and *Gardiner* v. *United States*, 24 A.F.T.R. 2d 69-6108 (D. Ariz.), appeal pending C.A. 9, No. 24,760.

Petitioner attacks the decision below on two grounds: (a) that the court of appeals misapplied the relevant principles of federal law concerning the "presently ascertainable" requirement (Pet. 7-13); and (b) that the court misinterpreted the restrictions imposed upon fiduciaries by New York law (Pet. 13-18).[2] Neither contention has merit.

(a) The Treasury Regulations on Estate Tax (Section 20.2055-2) have long provided that an estate tax deduction will be allowed for the present value of a charitable remainder interest preceded by a noncharitable life interest only if the remainder interest is "presently ascertainable, and hence severable from the noncharitable interest"; and that if the remainder is subject to a power to divert corpus to the noncharitable life beneficiary, the deduction is allowable only to the extent that corpus is "exempt from an exercise of the power."

*Ithaca Trust Co.* v. *United States*, *supra*, 279 U.S. at 154, involved a bequest of a charitable remainder

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and the opinion explains that it does not conflict with the opinion in the instant case. Even if the decisions of the Third Circuit were not in harmony with each other, the intra-circuit conflict (with respect to the laws of different states) would not furnish a basis for review by this Court. *Wisniewski* v. *United States*, 353 U.S. 901.

[2] The brief of the *amici curiae* in support of the petition advances essentially the same arguments.

interest preceded by a life estate in decedent's wife, with instructions to the trustee to invade principal in favor of the wife in such amounts "that may be necessary to suitably maintain her in as much comfort as she now enjoys." The Court held *(ibid.)* that this was a standard of invasion "fixed in fact and capable of being stated in definite terms of money," and accordingly allowed the charitable deduction; the possibility that the trust income might fall below the wife's living expenses was not "appreciably greater than the general uncertainty that attends human affairs" and could therefore be disregarded.

*Merchants Bank* v. *Commissioner, supra,* involved a power of invasion for the "comfort, support, maintenance, and/or happiness" of decedent's wife. Distinguishing *Ithaca Trust,* the Court held that this standard of invasion was too broad for allowance of a deduction for the charitable remainder despite the fact that Massachusetts law might restrict the discretion of the trustee more narrowly than a literal reading of the will would suggest. The Court stated (320 U.S. at 261) that: "Only where the conditions on which the extent of invasion of the corpus depends are fixed by reference to some readily ascertainable and reliably predictable facts do the amount which will be diverted from the charity and the present value of the bequest become adequately measurable."

Finally, in *Henslee* v. *Union Planters Bank, supra,* the decedent bequeathed an annuity to his mother, with instructions to invade corpus for her "pleasure, comfort and welfare," the remainder to go to charity. Again distinguishing *Ithaca Trust* and following its

*Merchants Bank* reasoning, the Court held this standard to be so indefinite as to preclude the charitable remainder from being presently ascertainable. In response to the executor's argument that the trustees were limited in the exercise of their invasionary power by their fiduciary responsibilities to the remaindermen, the Court noted (335 U.S. at 598-599 n.3) that "respondents' fiduciary duty to the ultimate beneficiaries, private and charitable, was ineffective to guarantee preservation of any predictable fraction of the corpus for disposition after the mother's death."

The court below properly applied the rationale of the above decisions to the instant case. The trustee here was granted the power, in its "sole and absolute discretion," to invest trust corpus and apportion trust income in such a manner as to effect substantial diminution of corpus through accelerated payout of income. For example, wasting assets could be purchased, with all income derived therefrom allocated to the income beneficiaries; indeed, "any other receipt whatsoever" could be ascribed to income. (Pet. App. 6). As the court below observed (Pet. App. 12), the resulting effect on trust corpus "is similar to the possibilities in direct invasion cases."

There is no warrant for petitioner's contention (Pet. 8-10) that this case is analogous to *Ithaca Trust*. In *Merchants Bank* and *Union Planters*, this Court made it clear that its prior decision in *Ithaca Trust* was to be confined to situations where the trustee's invasionary power was tied to a readily measurable standard existing at the time of the dece-

dent's death, such as the past support of the life beneficiary. No such situation is here presented. Here, as in *Merchants Bank* (320 U.S. at 261-262), the "extent to which the principal might be used was not restricted by a fixed standard," and hence did not lend itself to "reliable prediction." See also *Union Planters*, 335 U.S. at 599. Nor has petitioner cited any authority or offered a persuasive rationale for its asserted distinction (Pet. 10-11) between "direct" powers of invasion and "indirect" powers based upon the grant of broad administrative discretion. In either case, the possibility of diversion of trust principal is present. In fact, where as here the trustee has unfettered discretion to allocate between principal and income, this possibility may be even greater since the trustee is not limited to a specified purpose for which he may invade corpus for the benefit of the income beneficiary.[3]

(b) As for petitioner's second argument (Pet. 13-18)—that the court below erroneously interpreted

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[3] *Amici* mistakenly assert (Br. 4-8) that the Commissioner's position in this and related cases stems from a "changed interpretation of the law" first announced in Rev. Rul. 60-385, 1960-2 Cum. Bull. 77. That ruling was concerned only with the effect of a power to allocate capital gains distributions of regulated investment companies to an income beneficiary—only one of the many possible administrative powers which may alter the dividing line between a charitable remainder interest and a noncharitable life estate. The decedent here had long been put on notice that the existence of broad administrative discretion in the trustee might render an otherwise deductible charitable interest unascertainable for federal tax purposes. See, *e.g.*, *Colt* v. *Duggan*, 25 F. Supp. 268 (S.D. N.Y.); *State Street Trust Co.* v. *United States*, 263 F. 2d 635 (C.A. 1).

New York law—petitioner cites no authority to support the view that despite the absolute discretion granted to the trustee by the trust instrument, New York law imposes a standard of conduct upon the trustee so exacting as to satisfy the strict requirements of the "presently ascertainable" test. Indeed, New York courts have repeatedly held that powers similar to those conferred on the trustee in the instant case vest in him the broadest of discretion to contravene the rules of allocation normally imposed by law, even though his action may reduce the interest of either the life beneficiary or the remainderman; and that a court of equity will not question the trustee's exercise of discretion if it appears from the trust instrument that the settlor intended that allocation questions be resolved conclusively by the trustee rather than through litigation.[4] Clearly, under New York law the discretionary powers conferred by decedent upon her trustee were effective to allow at least some depletion of corpus below the date-of-death value. This uncertainty in and of itself suffices to prevent the remainder interest which would even-

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[4] See *e.g.*, *In re Estate of Davis*, 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct.); *In re Morron's Estate*, 10 Misc. 2d 861, 169 N.Y.S. 2d 783 (Surr. Ct.); *In re Harmon's Trust*, 5 Misc. 2d 308, 164 N.Y.S. 2d 468 (Sup. Ct.); *In re Liebmann's Trust*, 131 N.Y.S. 2d 144 (Sup. Ct.); *Chase National Bank* v. *Chicago Title & Trust Co.*, 246 App. Div. 201, 284 N.Y.S. 472, affirmed, 271 N.Y. 602, 659, 3 N.E. 2d 205; *In re Grover's Estate*, 24 Misc. 2d 857, 205 N.Y.S. 2d 537 (Surr. Ct.); *In re Sampson's Estate*, 193 Misc. 166, 83 N.Y.S. 2d 200 (Surr. Ct.); *In re Bruen's Estate*, 83 N.Y.S. 2d 197 (Surr. Ct.).

tually pass to charity, from being "fixed in fact and capable of being stated in definite terms of money." *Merchants Bank* v. *Commissioner*, *supra*, 320 U.S. at 263.

2. The decision below does not, as petitioner asserts (Pet. 19-24), conflict with that of the First Circuit in *Old Colony Trust Co.* v. *United States*, 423 F. 2d 601. The court there held that a decedent who had retained the power as trustee to pay out corpus to the life beneficiary of an inter vivos trust, if he deemed it in the beneficiary's "best interest," retained dominion and control over the trust property tantamount to ownership, and that therefore the value of the trust property was includible in his estate. By way of dictum, the court rejected the government's alternative contention that the presence of broad administrative powers in the trustee required the same result. It first noted that since its earlier decision in *State Street Trust Co.* v. *United States*, 263 F. 2d 635, the Supreme Judicial Court of Massachusetts had overruled prior law as expressed in *Dumaine* v. *Dumaine*, 301 Mass. 214, 16 N.E. 2d 625, and had held in *Old Colony Trust Co.* v. *Silliman*, 352 Mass. 6, 223 N.E. 2d 504, that a power to allocate trust receipts and expenses between income and principal permitted an exercise of discretion only in doubtful cases not covered by state law. Given this interpretation by the highest state court, the First Circuit stated that under Massachusetts law no aggregation of administrative powers could meet the test of "sufficient dominion and control so as to be equated with ownership" under Sections 2036 and

2038. The case at bar, of course, deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038.

3. The importance of the question presented has been diminished by the recent amendments to Section 2055 enacted in the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, 560. For charitable remainder trusts of decedents dying after December 31, 1969,[5] a deduction is allowable for a charitable remainder interest only if the trust qualifies as an "annuity trust" (under which the income beneficiary is to receive a stated dollar amount annually), or a "unitrust" (under which the income beneficiary is to receive an annual payment based on a fixed percentage of the net fair market value of the trust assets). Section 201(d), (e), and (g) of the Tax Reform Act of 1969. See S. Rep. No. 91-552, 91st Cong., 1st Sess., p. 87.

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[5] Except irrevocable trusts established before October 9, 1969, or revocable trusts of settlors who die before October 9, 1972, if the trusts were written on or before October 9, 1969.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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